

# ENTRY STRATEGY CONCEPTS, DETERMINANTS AND OPTIONS OF U.S. FIRMS INTO ROMANIA

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**Abstract:** *This article looks at entry strategy concepts and options, taking into account cultural and organizational parameters which influence success. Export, licensing and distribution, as well as joint ventures and facilities management are critically examined, from the point of view of the foreign companies intending to access Romanian market.*

**Keywords:** strategic marketing, entry strategies, US companies, Romanian market

## **Entry Strategy Concepts**

General theoretical research on entry strategy has identified a firm's level of involvement or control over an operation and resource commitment as critical dimensions upon which entry strategies can be categorized. Treagold distinguishes between three main entry strategies.(Treadgold, 1988) First, an entry strategy that affords a high degree of control is normally associated with high cost, such as acquisition, dominant shareholding or wholly owned greenfield investments. The second strategy involves medium cost and control, which is typically connected with 50:50 joint ventures. Third, a low cost strategy is said to imply a reduction in control, such as minority equity interests and franchise arrangements ( Treadgold, 1988). Within the literature, four variables appear to play substantial roles as to influencing the final determinants of entry strategy mode : psychic or cultural distance; organizational culture; international experience; and firm size.

### *Psychic or Cultural Distance*

Research into the factors affecting entry strategy has identified psychic or cultural distance as a key explanatory factor. This research has, however, produced conflicting results. Two opposing arguments can be identified throughout the literature. The first argument suggests that greater psychic or cultural distance will lead firms to adopt an entry strategy that is more independent.

This is attributed to the problems encountered by 'double layered acculturation', which requires a firm to adjust to both a different national and organisational culture (Barkema, Bell and Pennings, 1996). This argument is supported by the results of Brouthers and Brouthers who found that high levels of cultural distance or investment risk are associated with the use of high cost/high control entry strategies (Brouthers and Brouthers, 2001). The second argument suggests that where a firm enters a distant market it is more likely to adopt an entry strategy that incorporates an indigenous firm (Luo and Chen, 1995). This argument is based partly on the premise that shared-equity ventures enable foreign firms to delegate certain culturally sensitive management functions to the local firm. It is also

suggested that as the psychic distance between the home and foreign market increases, the perception of risk will be greater. Consequently, firms will be unwilling to commit substantial resources to psychically distant markets (Brouthers, K., 1995).

It is acknowledged, however, that psychic distance cannot explain a large proportion of the variance in entry strategy selection alone. The degree of centralisation of decision making, organizational culture, international experience, and size of the firm have all been shown to play an influential role in internationalization. Centralization of decision-making has been defined as “the amount of delegation of decision-making authority throughout an organization and the extent of participation by organizational members in decision-making” (Jaworski and Kohli, 1993) As centralization is primarily a control issue it can be argued that more centralized structures would prefer entry strategies that afford a high level of control for headquarters based in the home market. Moreover, decentralized or autonomous decision making structures may be more willing to adopt low control entry strategies.

### *Organizational Culture*

Organizational culture is a critical factor in determining a firm’s corporate strategy and direction. Consequently, it is an important variable when examining a firm’s entry strategy. Organizations can be classified as one of four cultures (Deshpande, Farley and Webster, 1993): First, a hierarchical culture emphasizes established procedures, rules and uniformity. Second, the clan culture stresses loyalty, tradition and commitment to the firm. Third, the market culture focuses on competitive actions and achievement. Fourth, an organization with an adhocracy culture is entrepreneurial, creative and flexible.

In his study of organizational culture as an antecedent to the export intention of firms Dosoglu-Guner found that a clan culture decreases and an adhocracy culture increases a firm’s probability of exporting to a foreign market (Dosoglu-Guner, 1999). The logic provided by Dosoglu-Guner’s study and Deshpande, et al’s. classification of organizational cultures suggests a positive relationship between organisational culture and entry strategy. For instance, a more entrepreneurial culture, such as adhocracy, is likely to take more substantial business risks and enter markets through high cost/high control strategies, whereas a hierarchy or clan culture may be more likely to adopt a low cost/low control strategy.

### *International Experience*

International experience has been shown to have important implications for entry strategy selection (Agarwal and Ramaswami, 1992) It is argued that as firms gain more international experience the level of uncertainty regarding operating in foreign markets will reduce, which, in turn, increases the likelihood that such firms will use high cost/high control entry strategies. Correspondingly, those firms with less international experience are more likely to enter a foreign market through a joint venture as a means of sharing the risks and responsibility (Caves and Mehra, 1986).

### *Firm Size*

In terms of firm size, White suggests that larger retailers, with greater financial resources, are more likely to use acquisition as a mode of entry, whereas small retailers will evaluate the relative benefits of franchising, concessions, distributors and

agents (White, 1995) This positive relationship between firm size and entry strategy is supported by the export literature which has found a strong association between firm size and high cost/high control entry strategies (Sarkar and Cavusgil, 1996).

### **Entry Strategy Determinants**

While many studies have made substantial contributions to the understanding of the entry mode behavior of firms, an important gap in the empirical literature is the issue of how the inter-relationships among the determinant factors – level of investment needed, level of risk tolerance, and level of control desired- influence firms' entry choices.

Within the literature, there seem to be three fundamental questions or issues each company must determine before making final decisions about their business involvement in an emerging markets like Romania:

- What is the level of risk the company is willing to accept in light of the inherent volatility emerging markets present?

Simply stated, ascertained risk is manageable risk. As already discussed, there are certain undeniable risks that come with pursuing commercial activities in emerging markets. Notwithstanding this truth, there are proven ways in which to minimize the level of risk and make it palatable with a firm's emerging market appetites. These methods concern themselves with the level investment to be made and the level of control the company (Erramilli, 1991).

- What is the level of investment the firm is willing to make to succeed in high-growth, emerging markets?

The capacity of a company to enter an emerging market and implement its primary strategy is obviously fundamental in setting realistic objectives. The formula for determining the level of investment is an in-depth and cogent analysis of the relationships between firm resources such as: management; capital; talent; production; processes; and, technology

The sum total of these is the demonstrated level of resource commitment on the part of the firm to conducting serious business in each selected emerging markets vs. merely an expanded version of an export sales strategy (Bowman, 1993).

- What is the level of control the company is seeking for their emerging market operations? (Caslione and Thomas, 2000).

In most cases, it is in a foreign company's interest to better monitor and control the sales and distribution of its products. For most companies, properly monitoring and controlling critical aspects of a local distributor's business rather than 'owing' the local business may be a much better approach to developing business in emerging markets. By better monitoring and controlling those activities within the distributor's business that are essential to successful sales and distribution, the distributor is more effectively managing their resources, their own money, staff, and other resources for the manufacturer's direct benefit as well as their own. This frees up scarce resources that might be better spent someplace else (Goodnow and Hansz, 1972).

Of course, every company will respond to each question differently depending on variable detailed earlier: However, before embarking on any venture into emerging markets, these answers need to be analyzed carefully, quantified wherever possible and commitments made upon on a per market basis. Enlightened and more serious companies address these critical issues being completely aware of the inherent realities and ‘minefields’ that are characteristic with doing business in emerging markets. Further, leading firms design and implement a primary strategy that guides them in their emerging markets activities.

The importance of examining the effects of inter-relationships derives from the fact that they may explain firm behaviors that cannot be captured by the independent effects of the factors. For example, firms that have lower levels of risk tolerance are expected to either not enter foreign markets or use a low-risk entry mode such as exporting. However, many such firms have been observed to enter foreign countries, especially those that have high market potential, using joint ventures and licensing arrangements (Anderson and Gatignon, 1986). This type of firm behavior can be better explained if the joint effect of the determinant factors are examined (Cavusgli and Nevin, 1981). Further, empirical research has consistently showed that the entry strategy chosen by most firms into a new market is neither exclusively by structural or managerial factors but is a product of both types of factors (Reid, 1981).

### Entry Strategy Options

There exist six specific entry strategy options available to U.S. companies who seek to enter high-growth emerging markets like Romania. When melded together, the determinants of entry strategy and the potential options look like this:



**Figure 1 – Emerging Market Entry Strategy Determinants and Sources**

Source: Caslione, John and Andrew Thomas, *Growing Your Business in Emerging Markets: Promise and Perils* (Quorum, London, 2000) p. 257

### Exporting

When a manufacturer is debating whether to sell their product abroad, the simplest and least risky way to do so is through exporting. Nevertheless, limited control as to what happens to the manufacturer’s products once they are ‘in-market’

needs to be accepted. As do lower profit and market share. The trade-off is low-levels of investment and risk.

Exporting is often done through manufacturer's agents, who represent a number of non-competing foreign suppliers in a particular market. The agents are typically residents of the country in which they are doing business and operate on a commission rather than take title to the goods (Reid, 1981). Some agents do maintain inventories of the products they represent, although most of the orders they take are in the name of the manufacturer. In most cases, emerging market manufacturer's agents are similar in nature to those of their industrialized world counterparts. American Home Products, a U.S.-based producer of prescription drugs, household goods, food, and candy, uses manufacturer's agents in selling to Eastern Europe. Nearly 30% of American Home Product's revenues come from this method of entry. This method for entering new markets is a reflection of America Home's strategy as it relates to their company's inputs (level of risk, level of investment, level of control). The resulting outputs (market share, revenue, profits) are directly impacted by America Home's inputs, or, in other words, their corporate culture (Casglione and Thomas, 2000).

Wholesale importers are another way in which manufacturer's can enter a new market using exporting. They import goods that are stocked for resale. Most wholesale importers are specialists in a particular field, such as chemicals or processed foods. Quite a number may have exclusive territories and, in return, agree not to handle competing brands. In this scenario, exclusivity is not a one-way street. Exclusivity works both ways and must be understood accordingly. Further, they may have their own sales forces to cover their territories and assist dealers. Wholesale importers generally purchase through manufacturer's agents when the exporter uses them, or directly from the manufacturer themselves (Casglione and Thomas, 2000).

Trading companies are important product outlets in many nations, especially those that tend to be underdeveloped. These import firms commonly own and operate grocery stores, department stores, automobile distributorships and dealerships, and farm machinery distributorships. In an expansion of the Snack Ventures Europe, PepsiCo and General Mills recently acquired Star Foods, a snack producer and distributor in Romania. Star Foods has one plant in Bucharest and produces Star Chips potato chips, Mr. Snacki corn snacks, and Krax Corn and potato snacks (*Snack Food ad Wholesale Bakery*, 2004).

### *Licensing*

Licensing (also known as franchising) is another thoroughfare available to manufacturer's looking to enter emerging markets. While the level of risk and investment required using the licensing strategy is usually higher than exporting, the amount of profitability and control over one's product is frequently greater. Licensing is the agreement between a manufacturer and a foreign firm to make and sell the manufacturer's products abroad. Within such an agreement, the profits are shared between the two companies. The normal arrangement is for the manufacturer (the licensor) to supply technical assistance to the licensee in such a way as to insure sufficient management strength and capital. The licensee receives the right to use the production processes, marketing strategies, and the licensor's trademarks (Caslione and Thomas, 2000).

In Eastern Europe, L&M Tobacco Company grants licenses to local to produce and distribute its products there. Although the overall level of investment is relatively low under the licensing strategy, the level of control may still not suitable

for a particular manufacturer. It is sometimes difficult to impose strong authority over a licensee's operation. Further, the licensee may eventually break the agreement and become a direct competitor to the licensor – raising the company's overall long-term risk substantially (Caslione and Thomas, 2000).

### *Distribution*

The most common way for manufacturers to expand into international markets is by using independent agents and distributors. Yet, a glance through almost any international business or international marketing textbook reveals a glaring omission: almost no one tackles the question of distribution. When the subject is addressed it is often conceptualized as a transportation issue (Neipert, 2000) a question of logistics (Beamish et al., 2000), or rolled into an analysis of international networks and market entry (Ellis, 2000).

The central issue of how to select, bargain with, and maintain a viable, working relationship with a distributor is relegated to a few paragraphs. Moreover, much of what has been written on international distribution covers topics relevant only up to the point where an agreement has been signed, to the neglect of ensuing monitoring and compliance issues. This is ironic, given the emphasis on relationship building in the field of international business.

Distributors have become powerful in the industrialized, western world. Consider the vast majority of products that are sold and distributed by entities other than the actual manufacturers.

Throughout the world, manufacturers are realizing, some for the first time and for some very painfully, the inescapable truth that an effective entry strategy based on distribution oftentimes provide the best way to ensure any degree of long-lasting success in emerging markets (Anderson and Coughlan, 1987) In other words, for the vast majority of companies seeking to take advantage of the tremendous opportunities emerging markets have to offer, a narrow range of distribution strategies that are best-suited to their corporate philosophy; the corporation's ability to invest in these markets; the amount of control desired; and, the level of acceptable risk can be developed on a market by market basis.

For example, if a company decides that a key input is a high-level of control over the sales, manufacturing, installation, servicing and/or distribution of their products within a selected distributor's operation, then the appropriate resources can be identified to integrate selected key functions of the manufacture's business into those same functions in the distributor's business, vs. integration of the distributor's functions into the manufacturer's business. Although its critical importance cannot be overstated, distribution is generally the most globally differentiated and least understood of all marketing mix components. It is also the component most likely to hinder the success in foreign markets for especially small and mid-sized companies. Proper distribution planning can ensure that the best available channels and distribution methods are in place to efficiently and economically move products and services to customers.

### *Facilities Management*

The option of facilities management is becoming more of a preferred entry strategy option as the arms of globalization reach further and further into the developing world (Green and Barclay, 1995). As foreign direct investment flows ever-

increasingly around the world, facilities which were intended for one user have been, instead, leased or rented to another. Overbuilding of physical facilities, i.e. warehouses, manufacturing plants in high-growth markets, particularly in Asia, have lead to an over-supply (Fill and Visser, 2000). For many firms who don't wish to jump into a new market through the riskier and costlier joint venture or direct invest modes, facilities management provides a way to maintain a good degree of control.

### *Joint Venture*

For many U.S. executives who have a relationship perspective, a joint venture in an emerging market is perhaps viewed as a good choice for entry. Awareness, credibility, trust, and chemistry are the principles that govern the relationship. The belief that business relationships are akin to marriages, has gained currency in academic discussion about joint ventures, as well as in the actual practice of strategic alliances. One author put it this way:

“There is an initial period of courtship when two or more companies determine whether they share a common business vision and if their resources and skills are complementary. Chemistry is also extremely important, because personalities as well as business ideologies have to blend in order for the partnership to work. If the chemistry is there, then the foundation has been laid to build a relationship of trust and mutual commitment. Potential problems should be discussed in advance to avoid any later irreconcilable differences. Once all parties are in accord, then they can enter into a legal agreement.”( Mason, 1993).

The marriage metaphor was introduced by Levitt (1983) and has been used widely in articles and books addressing relationship marketing and joint ventures. Even when this metaphor is not stated explicitly, it has become pervasive throughout much of the popular business literature, including the sales and strategic alliance literatures. Firms are engaged in the “search for compatibility” , the quest for “trust, harmony, and confidence in a relationship” and the values of “bonding, empathy, reciprocity, and trust” (Yao et al., 2000)

Beamish et al. (2003) note that while managers are constantly being urged to select alliance and joint venture partners who are trusted, it is something that doesn't happen right way. Trust takes time and is often slow to develop. Once developed, trust is among the most powerful of business forces. For all of this, the level of risk, investment, and control is quite high, while firms choosing the joint venture option should expect higher-than-average outputs such as profits, sales, or market share.

### *Direct Investment*

Direct investment is the most comprehensive option available to manufacturer's looking to 'break-in' to emerging markets. The direct approach allows the manufacturer to acquire the highest degree of control over foreign marketing with a larger amount of profits to be reasonably expected. Whether through acquisition of a local firm, or the creation of completely new, self-contained entity, direct invest is by far the most comprehensive. For example, Union Carbide, the global manufacturer of batteries, antifreeze products, chemicals and pesticides has 100% company-owned manufacturing and distribution facilities in Hungary and Poland. These operations provide approximately 60 percent of the company's total revenues (Beamish et al., 2003).

As a rule, the level of investment required is quite substantial and the level of risk is also very high. In addition, the direct approach requires that the manufacturer acquire specific skills in doing business abroad that other entry strategies do not demand, further increasing the level of investment. At the same time, companies in some industries have little choice but to directly invest heavily into full in-market operations merely because of the nature of their business, their products, etc. Do-it-yourself stores are no exception. In 2002, the French Bricostore was the first do-it-yourself store to open in Romania. Its success was followed by Prakiter who has become the market leader (*Coatings World*, 2004).

For the vast majority of companies seeking to take advantage of the tremendous opportunities an emerging market like Romania has to offer, an entry strategy that is best-suited to their corporate philosophy; the corporation's ability to invest in these markets; the amount of control desired; and, the level of acceptable risk must be developed. Furthermore, the approach chosen by each company will require each company to develop appropriate functions and operations to adequately support the strategies chosen.

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